

**STATE OF ALASKA
RETIREE HEALTH FUND**
(an Internal Service Fund of the State of Alaska)

Financial Statements

June 30, 1998

STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

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601 West Fifth Avenue
Suite 700
Anchorage, AK 99501-2258

Independent Auditors' Report

**Division of Retirement and Benefits
Retiree Health Fund:**

We have audited the accompanying balance sheet of the State of Alaska Retiree Health Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 1998, and the related statements of revenues, expenses and changes in retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Alaska Retiree Health Fund (Plan), an Internal Service Fund of the State of Alaska, as of June 30, 1998, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

September 24, 1998



Member Firm of KPMG International

STATE OF ALASKA
RETIREE HEALTH FUND
(an Internal Service Fund of the State of Alaska)

Balance Sheet

June 30, 1998

Assets:

Investment in State of Alaska General Fund and other non-segregated investments pool (note 3)	\$ 35,800,043
Deposit with NYLCare (note 4)	555,490
Premiums receivable (note 6)	<u>22,000,000</u>
Total assets	<u>\$ 58,355,533</u>

Liabilities and Fund Equity:

Liabilities:

Accrued expenses	\$ 323,424
Estimated claims incurred but not paid (note 5)	<u>20,418,401</u>
Total liabilities	20,741,825

Fund equity:

Retained earnings	<u>37,613,708</u>
Total liabilities and fund equity	<u>\$ 58,355,533</u>

See accompanying notes to financial statements.

**STATE OF ALASKA
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Statement of Revenues, Expenses and Changes in Retained Earnings

For the year ended June 30, 1998

Revenues:

Health insurance premiums (note 6)	\$ <u>131,652,324</u>
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Expenses:

Benefits	92,188,450
Administrative expenses	<u>3,903,390</u>

Total expenses	96,091,840
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Operating income	35,560,484
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Investment income	<u>2,053,224</u>
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Net income	37,613,708
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Retained earnings, beginning of year	<u>—</u>
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Retained earnings, end of year	\$ <u><u>37,613,708</u></u>
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See accompanying notes to financial statements.

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Statement of Cash Flows

For the year ended June 30, 1998

Operating activities:	
Operating income	\$ 35,560,484
Adjustments to reconcile operating income to net cash provided by operating activities:	
Increase in accrued expenses	323,424
Increase in estimated claims incurred but not paid	20,418,401
Increase in premiums receivable	<u>(22,000,000)</u>
Net cash provided by operating activities	<u>34,302,309</u>
Investing activities:	
Investment income	<u>2,053,224</u>
Net increase in cash	36,355,533
Cash and cash equivalents, beginning of year	<u>—</u>
Cash and cash equivalents, end of year	<u>\$ 36,355,533</u>

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 1998

(1) DESCRIPTION

The following brief description of the State of Alaska Retiree Health Fund (Plan), an internal service fund of the State of Alaska (State), is provided for general information purposes only. Participants should refer to the Retiree Group Insurance Information Booklet for more complete information.

(a) General

The Plan was established to provide self-insured healthcare benefits to retirees of the Public Employees' Retirement System, Teachers' Retirement System, Judicial Retirement System and Elected Public Officers Retirement System (collectively referred to as the Retirement Systems) beginning July 1, 1997. The Plan is an internal service fund of the State financial reporting entity and is included as such in the State's financial reports. As of June 30, 1998, there were approximately 19,000 retirees, excluding dependents, covered by the Plan.

Prior to July 1, 1997, healthcare benefits for retirees were fully insured through the payment of premiums to an insurance company.

(b) Benefits

The Plan offers medical, voluntary dental-vision-audio (DVA) and voluntary long-term care (LTC) benefits to eligible benefit recipients of the Retirement Systems and their dependents.

Medical

The Plan covers, automatically at no cost, benefit recipients of the Retirement Systems, as well as benefit recipients of the Marine Engineers Beneficial Association who retired from the State after July 1, 1986, except for the following who must elect coverage and pay a premium:

- Benefit recipients of the Public Employees' Retirement System (PERS) if they were first hired under the PERS on or after July 1, 1986, who are under age 65 and are not receiving a disability benefit.
- Benefit recipients of the Teachers' Retirement System (TRS) if they were first hired under the TRS on or after July 1, 1990, who are under age 65 and are not receiving a disability benefit.
- Benefit recipients of the PERS if they were first hired under the PERS on or after July 1, 1996, are age 65 or older and who do not have at least 10 years of credited service.
- Benefit recipients under a Qualified Domestic Relations Order (QDRO).

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June 30, 1998

Voluntary DVA and LTC

Individuals receiving benefits from one of the Retirement Systems, excluding alternate payees under a QDRO, may elect coverage for themselves and their eligible dependents. If coverage is elected, the premiums are paid by deductions from retirement checks.

(c) Administration

The Plan is administered by the State's Division of Retirement and Benefits (DRB). DRB utilizes the services of a claims administrator, NYLCare Health Plans (NYLCare), to process all medical, dental and audio claims. NYLCare has contracted with Express Scripts, Inc. (ESI) to process all prescription drug claims for the State. Vision benefits provided by the Plan are administered by Vision Service Plan (VSP).

(d) Funding

The Plan is self-insured for all benefits. The Plan's funding policy provides for the collection of premiums from the Retirement Systems and benefit recipients, as applicable. Premium amounts are actuarially determined on an annual basis and adjusted as necessary. The Retirement Systems retain the risk of loss of allowable claims.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The Plan's financial statements are prepared using the accrual basis of accounting. Premiums are recognized in the period in which they are due. Benefits are recognized when due and payable.

(b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Investments

Investments are recorded at fair value. Fair value is "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than in a forced or liquidation sale."

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The Plan is a participant in the State General Fund and Other Non-Segregated Investments (GeFONSI) pool. GeFONSI is comprised of the invested assets of the State General Fund and certain other funds that are commingled for investment purposes. GeFONSI invests primarily in pooled marketable debt securities.

Fair value pricing of pooled marketable debt securities is performed daily by the custodian utilizing an independent pricing service. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates, if applicable. Securities not traded on a national or international exchange are based on equivalent values of comparable securities with interest rates for similar instruments. Fair value has been established as the midpoint between the bid and asked prices. The cost of debt and equity investments is determined on the average cost basis.

GeFONSI investment income is distributed to participants as prescribed by statute or if appropriated by the State legislature.

(d) *Statement of Cash Flows*

For purposes of reporting cash flows, cash and cash equivalents include the Plan's investment in GeFONSI and the Plan's deposit with NYLCare. Both of these balances have the general characteristics of demand deposit accounts.

(e) *Federal Income Tax Status*

The Plan is exempt from federal income taxes under Section 501(a),

(3) CUSTODIAL CREDIT RISK

The Governmental Accounting Standards Board (GASB) Statement No. 3 requires a disclosure regarding custodial credit risk to indicate the chance of loss in the event a financial institution or third party holding the Plan's securities fails. At June 30, 1998, the Plan's investments are represented by participation in GeFONSI, which primarily invests in pooled fixed income securities. Although pooled fixed income securities represent the GeFONSI's share of ownership in the pool rather than ownership of specific securities, all of the underlying securities in the pools in which the GeFONSI participates are considered to be Category 1 as defined by GASB Statement No. 3. As such, investments are insured or registered, or securities are held by the State or its custodian in the State's name. Category 1 is the highest level of safekeeping security as defined by GASB. The deposit with NYLCare (note 4) is classified as Category 3 because the related bank account is not in the State's name.

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(4) DEPOSIT WITH NYLCare

The Plan is required to maintain a cash balance with NYLCare for the payment of medical, dental and audio claims. The cash balance also facilitates the payment of valid prescription drug and vision claims and is used to pay ESI and VSP, respectively. Amounts disbursed from the cash balance are reimbursed by the Plan to NYLCare on a weekly basis.

(5) CLAIMS INCURRED BUT NOT PAID

The Plan has established a liability as of June 30, 1998 for estimated claims incurred but not paid. This amount was actuarially estimated using the completion factor approach. The underlying principle of this approach is that contingencies affecting the progression of claims payments for a particular claim are inherently and properly modeled by an assumed runoff pattern. This runoff pattern is used to estimate claims incurred before year-end but not paid until subsequent to year-end.

(6) PREMIUMS

During the year ended June 30, 1998, the Plan received a \$9,000,000 refund of reserves from the insurance company which provided coverage to retirees prior to July 1, 1997. These reserves were retained by the insurance company to cover claims submitted subsequent to July 1, 1997, but incurred prior to that date. The refund amount is reflected as health insurance premiums in the financial statements.

As of June 30, 1998, the Plan is awaiting the return of an additional \$22,000,000 of reserves from the same insurance company related to long-term care. This amount is reflected as premiums receivable in the financial statements and is considered fully collectible by the Plan.